

REPORT OF THE AUDITOR-GENERAL TO THE FREE STATE LEGISLATURE AND
THE COUNCIL ON THE FINANCIAL STATEMENTS AND PERFORMANCE
INFORMATION OF THE MALUTI-A-PHOFUNG LOCAL MUNICIPALITY FOR THE
YEAR ENDED 30 JUNE 2008

REPORT ON THE FINANCIAL STATEMENTS

Introduction

1. I was engaged to audit the accompanying financial statements of the Maluti-a-Phofung Local Municipality which comprise the statement of financial position as at 30 June 2008, statement of financial performance, statement of changes in net assets/equity and cash flow statement for the year then ended and a summary of significant accounting policies and other explanatory notes as set out on pages xx to xx.

Responsibility of the accounting officer for the financial statements

2. The accounting officer is responsible for the preparation and fair presentation of these financial statements in accordance with the basis of accounting determined by the National Treasury, as set out in accounting policy note 1 and in the manner required by the Local Government: Municipal Finance Management Act, 2003 (Act No. 56 of 2003) (MFMA) and the Division of Revenue Act, 2007 (Act No. 1 of 2007) (DoRA). This responsibility includes:
 - designing, implementing and maintaining internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error
 - selecting and applying appropriate accounting policies
 - making accounting estimates that are reasonable in the circumstances.

Responsibility of the Auditor-General

3. As required by section 188 of the Constitution of the Republic of South Africa, 1996 read with section 4 of the Public Audit Act, 2004 (Act No. 25 of 2004) (PAA) and section 126(3) of the MFMA, my responsibility is to express an opinion on these financial statements based on conducting the audit in accordance with the International Standards on Auditing and *General Notice 616 of 2008*, issued in *Government Gazette No. 31057 of 15 May 2008*. Because of the matters discussed in the Basis for disclaimer of opinion paragraphs, however, I was not able to obtain sufficient appropriate audit evidence to provide a basis for an audit opinion.

Basis of accounting

4. The municipality's policy is to prepare financial statements on the basis of accounting determined by the National Treasury, as set out in accounting policy note 1.

Basis for disclaimer of opinion

Cash and cash equivalents

5. The bank statement balance was disclosed incorrectly in note 15 to the financial statements and differed by R4 875 345 from the amount disclosed in the statement of financial position. This was because a savings account was included twice in the note.
6. Unallocated direct deposits included in the bank account increased from R8 337 340 in 2007 to R372 122 154 in 2008. This matter was also reported in paragraph 41 of the previous audit report and paragraph 5 of the 2006 audit report. I was unable to confirm the occurrence, completeness and accuracy of this balance.

Property, plant and equipment

7. The asset register was the only record of assets held by the municipality that supported the property, plant and equipment as disclosed in the statement of financial position and in note 9 to the financial statements. It could not be relied on for audit purposes due to various deficiencies revealed during the audit. This included the following:
 - 7.1. The opening and closing balances of the carrying amount of assets reflected in the statement of financial position differed from the asset register by R9 337 797.
 - 7.2. The accumulated depreciation in the financial statements was R225 785 950 more than the amount in the asset register.
 - 7.3. The additions on the asset register included items to the value of R5 597 751 which were acquired in the previous financial year and therefore the amount of additions disclosed in note 9 to the financial statements was R5 597 751 less than the additions on the asset register. I was unable to perform alternative procedures to confirm the completeness, accuracy and existence of this amount.
 - 7.4. Property, plant and equipment to the value of R3 081 583 were identified that were duplicated in the asset register. These items were recorded once with and once without VAT. Additional property, plant and equipment totalling R5 637 493 were identified in the asset register that were recorded inclusive of VAT, resulting in an overstatement of R692 324.
8. As a result of the detail as noted below I was unable to obtain sufficient appropriate audit evidence as to the existence, rights and valuation of property, plant and equipment to the value of R641 120 496 (2007: R629 207 728) as disclosed in note 9 to the financial statements. I was also not able to execute alternative procedures to confirm the existence, completeness and valuation of the balance.
 - 8.1. Supporting documentation could not be obtained for adjustments effected to the financial statements processed the previous year which decreased property, plant and equipment by R8 900 000 and adjustments of R205 985 349 made to

the opening cost of property, plant and equipment during the first-time implementation of the GRAP/GAMAP/GAAP basis of accounting the previous year, as well as R32 400 000 posted subsequent to implementation. The financial system did not provide for the execution of alternative audit procedures to confirm these amounts.

- 8.2. Numerous assets in the asset register totalling R2 780 172 (2007: R35,6 million) could not be physically identified for inspection and I was thus unable to obtain sufficient appropriate audit evidence as to the existence of these items of property, plant and equipment. This matter was also reported in paragraph 27 of the previous year's audit report.
- 8.3. I was unable to obtain sufficient appropriate audit evidence as to the completeness of and rights relating to municipal land included in the valuation roll. The property could not be traced to the asset register and the financial statement disclosure. There was no unique reference between the asset register and the valuation roll.
- 8.4. Adequate appropriate audit evidence regarding the ownership of property amounting to R11 907 804 could not be obtained from title deeds or other sources, as reported in paragraph 28 of the previous year's audit report. The existence, rights and valuation of assets totalling R75 000 000 that were transferred from the former Qwa-Qwa government to the municipality and had been reported on since 1994 could still not be confirmed. I was unable to perform alternative procedures to confirm these amounts.
- 8.5. I was unable to obtain sufficient appropriate audit evidence regarding the existence and valuation of items of property, plant and equipment amounting to R3 960 005.
- 8.6. Expenditure to the value of R10 189 719 which related to the construction of VIP toilets on land not owned by the municipality was capitalised and included in the asset register. This resulted in an overstatement of assets and an understatement of capital expenditure by this amount.

Receivables

9. The opening balances of consumer debtors and other debtors differed from the prior year closing balances by R21 712 879 and R320 675 respectively. I was unable to obtain audit evidence to explain these differences or to perform alternative procedures to confirm the completeness and accuracy of the amounts carried over.
10. I was unable to obtain sufficient appropriate audit evidence as to the existence and valuation of consumer debtors of R4 317 032 and other debtors of R1 705 641. This placed a limitation on the scope of the audit as the financial systems of the municipality did not make provision for alternative procedures to confirm this amount.
11. A cash suspense account of R369 747 335 included under other debtors was not cleared. These amounts should have been matched to bank deposits made and

are represented by the unallocated direct deposits balance reported in paragraph 6. I was unable to obtain sufficient appropriate audit evidence regarding the valuation of and rights and obligations relating to the cash suspense account.

12. I was unable to obtain sufficient appropriate audit evidence in respect of amounts totalling R10 112 160 (2007: R9,4 million) included in other debtors and the accuracy, completeness and valuation could not be confirmed. These amounts had been carried over from the prior year to the current financial year and showed little or no movement. This matter was also reported in paragraph 75 of the previous year's report and alternative procedures could not be executed to confirm these amounts.
13. Supporting documentation could not be obtained for a journal recorded against pre-paid sales shortages and included under other debtors in note 14. The accuracy, completeness and valuation of the transaction amounting to R2 010 817 could not be confirmed. Alternative procedures could not be executed to confirm this amount.
14. The provision for the impairment of receivables as reflected in note 13 was understated by R5 227 766 (2007: R81 780 049). This resulted in an overstatement of receivables and an understatement of expenditure by this amount.

15. Creditor provisions of R6 652 106 were incorrectly allocated to other debtors. Receivables and payables as reflected in notes 14 and 6 respectively were understated by this amount.
16. Employee costs of R5 141 921 were incorrectly included in other debtors. Receivables as reflected in note 14 were overstated and employee costs reflected in the statement of financial performance understated by these amounts.

Payables

17. The opening balances of consumer deposits and trade creditors differed from the closing balances of the previous year and were overstated by R5 197 241 and R5 183 928 respectively. I was unable to obtain audit evidence to explain these differences or to perform alternative procedures to confirm the completeness and accuracy of the amounts carried over.
18. The comparative figure for creditors in note 6 to the financial statements was R13 876 071 more than the amount disclosed in the statement of financial position. Reasons for the difference could not be obtained and I was unable to perform alternative procedures to confirm the accuracy of the amount transferred.
19. I could not obtain sufficient audit evidence to confirm the existence and valuation of payments received in advance of R3 420 445. Appropriate audit evidence could also not be obtained with regards to journal entries to the amount of R15 168 398, including a correction of a prior year adjustment of R13 876 072, to confirm the completeness, existence and valuation of these amounts. Alternative procedures could not be executed to confirm this amount.

20. Creditor reconciliations were not performed on a regular basis to ensure that obligations were disclosed correctly. This resulted in an amount of R11 849 737 not being provided for as outstanding to the municipal entity and an understatement of creditors as reflected in note 6, as well as expenditure.

21. Receipts totalling R4 486 537 were captured twice on the billing system. This resulted in an overstatement of payables and an understatement of receivables by this amount.

Revenue

22. GAMAP 9 – *Revenue*, paragraph 61 requires that all significant amounts should be disclosed separately. The following amounts should have been disclosed separately under Other Income:

- Human resources R345 872
- Parks and gardens R1 851 251
- Electricity R977 155

23. The occurrence and accuracy of property rates could not be confirmed as supporting documentation for journals of R5 265 667 could not be obtained. I was unable to execute alternative procedures regarding these amounts.

24. Property rates for March 2008 were overcharged by R13 101 753, resulting in property rates income and receivables being overstated.

Expenditure

25. Supporting documentation for expenditure towards the construction of a website for the municipality amounting to R3 368 901 was removed from the municipal premises and the transaction is subject to an investigation. Sufficient appropriate evidence of the accuracy, existence and completeness of this expenditure could not be obtained and alternative procedures were not possible to confirm the expense.

26. Supporting documentation for credit notes from suppliers to the amount of R2 141 256 could not be obtained. Alternative procedures could not be executed to confirm the completeness, occurrence and accuracy of this amount.

27. Sufficient supporting documentation for an amount of R26 662 522 reflected as other expenditure in the statement of financial performance could not be obtained. I was not able to perform alternative procedures to confirm this amount.

28. Supporting documentation for journals to the amount of R797 511 could not be obtained. Alternative procedures could also not be executed to confirm the completeness, occurrence and accuracy of expenditure.

29. Water and electricity purchases of R8 498 298 were recorded in the 2007-08 instead of the 2006-07 financial year, resulting in an overstatement for 2007-08 and an understatement for 2006-07 of bulk purchase as reflected in note 23 to the financial statements by this amount. It also resulted in an overstatement of the current year's deficit.

30. The expenditure for the provision of leave amounting to R6 623 493 was allocated to contributions on the statement of financial performance. It should have been allocated to employee costs and therefore these totals were overstated and understated respectively by this amount.

Accumulated surplus/deficit

31. The opening balance of the accumulated surplus/deficit in the general ledger was R4 261 016 less than the closing balance in the statement of changes in net assets for the previous year and was therefore understated.

32. Paragraph 5 of the previous year's audit report indicated that there were journals of R25 722 549 which resulted in an understatement of the accumulated surplus. As detailed in paragraphs 20 and 21 of the previous year's audit report, supporting documentation and narrations to journals did not present an adequate audit trail to substantiate debit transactions amounting to R12 500 000, and backlog depreciation of R149 500 000 that was processed against the accumulated surplus. Paragraph 12 of the previous year's audit report also indicates that audit adjustments of R11 000 000 that were not substantiated were processed on the financial statements of the previous year. The total of the debit balances on the prior year's trial balance was R5 224 592 more than the total of the credit balances.

Employee costs

33. Amounts relating to councillors' remuneration in notes 20 and 21 to the financial statements were understated by R17 790 673 (2007: R5 259 586) and differed from the amount in the statement of financial performance.

34. The Skills Development Levy of R506 089 was not allocated to employee costs, but to a suspense account disclosed under receivables. An amount of R1 518 644 was included in the opening balance of this account and therefore employee costs and receivables were understated and overstated by R2 024 733 respectively.

Grants and subsidies

35. The amount according to the statement of financial performance in respect of grants and subsidies received was R23 264 668 more than the amount in the general ledger. The difference could not be explained at the time of the finalisation of the audit. I was unable to confirm the accuracy of this amount by means of alternative procedures.

36. Grants and subsidies paid according to note 24 to the financial statements amounted to R19 758 436. This was R18 237 083 less than the amount disclosed in the statement of financial performance.

37. Paragraph 39 of IAS 20 - *Accounting for Government Grants and Disclosure of Government Assistance* requires the following disclosure that was not made for all grants in note 18 to the financial statements:

- the nature and extent of government grants recognised in the financial statements and an indication of other forms of government assistance from which the entity has directly benefited; and
- unfulfilled conditions and other contingencies attached to the government assistance that has been recognised.

Investments

38. The completeness and valuation of investments could not be confirmed. The total amount of investments reflected in note 10 to the financial statements was R4 032 511 less than the general ledger but R1 756 010 more than the investment register. External investment statements could not be obtained to evaluate the balance. Alternative procedures on these balances could not be executed. Journals processed to the amount of R17 200 000 were not adequately supported by documentation and had been reported on in paragraph 60 of the previous year's report.

39. IFRS 7 - *Financial instruments* defines the short-term portion of long-term investments to be the amount redeemable within twelve months from the reporting date. Included in the amount disclosed in the statement of financial position was an investment totalling R9 034 718 which was not redeemable within twelve months from the reporting date. The short-term portion and the long-term portion of investments were overstated and understated respectively by this amount.

Investment in associate

40. The retained loss reflected in note 43 to the financial statements amounting to R10 844 920 differed from the amount in the financial statements of Maluti-a-Phofung Water (Pty) Ltd of R643 760. No explanation for the difference could be obtained at the time of finalising the audit report.

Provisions

41. The provision for bonuses payable as disclosed in note 5 was R2 099 279 less than the amount calculated for the provision. This also resulted in an understatement of expenditure for the provision.

Leases

42. Paragraph 41 of GRAP 13 - *Leases* requires the disclosure of the net carrying amount of assets that serve as security for lease liabilities. Note 2 to the financial statements, Long-term liabilities, has a brief disclosure that the finance leases are secured by the specific item for which the finance lease was issued. This disclosure is inadequate to satisfy the requirements of the said statement. This matter was also reported in the audit report of the previous year.

43. The capitalised lease liability for assets held to the amount of R1 089 980 was not disclosed in the financial statements.

Commitments

44. Sufficient appropriate audit evidence regarding capital commitments of R90 663 618 as disclosed in note 30 to the financial statements could not be obtained. Alternative procedures could not confirm the correctness of this figure.

Irregular expenditure

45. Councillors' remuneration for certain councillors exceeded the limits set in *Government Gazette No. 30600 of 18 December 2007*. Section 167(1) of the MFMA stipulates that political office-bearers and members of the municipal political structures may not receive more than the limits prescribed by the Public Office-Bearers Act, 1998 (Act No. 20 of 1998). The total overpayment identified was R645 236 (2007: R2 191 994) and should be disclosed as irregular expenditure in the notes to the financial statements in terms of section 125 of the MFMA, which was not done. This also occurred in the previous year and was also reported in paragraph 94 of the previous year's audit report.

Fruitless and wasteful expenditure

46. Municipal infrastructure grant (MIG) operational expenditure was incurred to the amount of R2 786 677 and the VAT of R342 223 was not claimed although valid VAT invoices were received. This resulted in fruitless and wasteful expenditure which should have been disclosed as required by section 125 of the MFMA.

47. Other fruitless and wasteful expenditure resulting from penalties and interest on late payments to SARS amounted to R223 788 and was not disclosed as required by section 125 of the MFMA.

Unauthorised expenditure

48. The actual and budgeted expenditure reflected in appendix E to the financial statements were R705 625 787 and R389 308 651 respectively. This resulted in unauthorised expenditure amounting to R316 317 136 which was not disclosed as required by section 125 of the MFMA.

Basis of preparation

49. The basis of preparation of the financial statements does not comply with *General Notice 552 of 2007*, issued in *Government Gazette no.30013 of 29 June 2007*, on the basis of accounting to be applied by municipalities and municipal entities in preparation of their separate and consolidated and financial statements for the year ending 30 June 2008.

50. Note 45 to the financial statements states that comparative figures might not be consistent with the current year figures due to the influence of exemptions utilised in the 2006-07 financial statements. This is not acceptable as GRAP 3 - *Accounting Policies, Changes in Accounting Estimates and Errors* requires that the impact of changes in accounting policies must be disclosed in the financial statements.

51. Paragraph 75(e) of GRAP 17 - *Property, Plant and Equipment* requires additional disclosure on fixed assets as was disclosed in appendix B to the financial statements. However, this disclosure was not included in note 9 to the financial statements which resulted in the financial statements not complying with the requirements of the standard.
52. According to paragraph 49 of GRAP 3 - *Accounting Policies, Changes in Accounting Estimates and Errors*, correction of prior year errors should disclose the nature of the error, the amount of the correction against each financial statement item and the correction amount at the beginning of the earliest prior period presented. If retrospective restatement is impracticable for a particular prior period, the circumstances that led to the existence of that condition and a description of how and from when the error has been corrected should be disclosed. The correction of error as disclosed in note 37 to the financial statements did not disclose this information.
53. Paragraph 48 of GRAP 1 - *Presentation* requires that the nature and amounts of and reasons for reclassifications must be disclosed on the financial statements. The provision for leave for the previous year amounting to R1 568 140 was previously disclosed in note 5 relating to provisions. In the 2007-08 financial statements it was reclassified and allocated to note 6 on creditors. The financial statements did not disclose the information as required by the standard.
54. According to GRAP 1 - *Presentation*, liabilities should be classified as current liabilities if the entity does not have an unconditional right to defer settlement of the liability for at least twelve months after year-end. In the case of consumer deposits the municipality does not have such a right and consumer deposits to the amount of R9 045 077 (2007: R3 813 207) should be disclosed as current liabilities and not as non-current liabilities in the statement of financial position.
55. The amount of cash generated from operating activities disclosed in the cash flow statement differed from note 25 to the financial statements by R11 304 663. This difference included the following:
 - Contributions to leave to the amount of R6 623 493 disclosed separately regardless of the fact that it was included in creditors
 - Movement in creditors was R27 752 143 less than the amounts in the statement of financial position
 - Movement in debtors was R33 319 908 less than the amounts in the statement of financial position
 - Movement in VAT was R5 703 836 less than the amounts in the statement of financial position
 - An amount for under- and overprovisions to the value of R7 807 353 without any corresponding balances on the statement of financial position
56. According to paragraph 41(b) of GAMAP 12 - *Inventory*, the different categories of inventory should be disclosed separately. The disclosure in note 12 to the financial statements did not comply with this requirement.

Disclaimer of opinion

57. Because of the significance of the matters described in the Basis for disclaimer of opinion paragraphs, I have not been able to obtain sufficient appropriate audit evidence to provide a basis for an audit opinion on the financial statements of the Maluti-a-Phofung Local Municipality. Accordingly, I do not express an opinion on the financial statements.

Emphasis of matters

I draw attention to the following matters:

Going concern

58. The statement of financial performance on page 8 of the financial statements indicates that the municipality incurred a deficit of R173 674 815 for the year ended 30 June 2008 compared to a surplus of R76 838 502 the previous year. The accounting officer's report in paragraph 6 also highlights the concern over the effect of the increase in outstanding debtors.

59. The difficulties being experienced by the municipality in recovering all debts due to it, as well as the potential negative effect of this tendency on the cash flows of the municipality, indicate that there is a risk that the municipality may be exposed to serious financial problems, which may require provincial or national intervention arising from financial crisis as set out in terms of sections 139 and 150 of the MFMA.

Other matters

I draw attention to the following matters that relate to my responsibilities in the audit of the financial statements:

Internal controls

60. Section 62(1)(c)(i) of the MFMA states that the accounting officer must ensure that the municipality has and maintains effective, efficient and transparent systems of financial and risk management and internal control. The table below depicts the root causes that gave rise to the inefficiencies in the system of internal control, which led to the disclaimer of opinion. The root causes are categorised according to the five components of an effective system of internal control. In some instances deficiencies exist in more than one internal control component.

Reporting item	Control environment	Risk assessment	Control activities	Information and communication	Monitoring
Cash and cash equivalents			✓	✓	
Property, plant and equipment			✓	✓	
Receivables		✓	✓	✓	
Payables	✓		✓	✓	
Revenue			✓		

Reporting item	Control environment	Risk assessment	Control activities	Information and communication	Monitoring
Expenditure			✓	✓	
Accumulated surplus/deficit				✓	
Employee costs			✓		
Grants and subsidies				✓	
Investments	✓			✓	✓
Investment in associate				✓	
Provisions				✓	
Leases				✓	
Commitments				✓	
Irregular expenditure			✓		
Fruitless and wasteful expenditure			✓		
Unauthorised expenditure			✓	✓	
Basis of preparation			✓	✓	
<u>Control environment:</u> establishes the foundation for the internal control system by providing fundamental discipline and structure for financial reporting.					
<u>Risk assessment:</u> involves the identification and analysis by management of relevant financial reporting risks to achieve predetermined financial reporting objectives.					
<u>Control activities:</u> policies, procedures and practices that ensure that management's financial reporting objectives are achieved and financial reporting risk mitigation strategies are carried out.					
<u>Information and communication:</u> supports all other control components by communicating control responsibilities for financial reporting to employees and by providing financial reporting information in a form and time frame that allow people to carry out their financial reporting duties.					
<u>Monitoring:</u> covers external oversight of internal controls over financial reporting by management or other parties outside the process; or the application of independent methodologies, like customised procedures or standard checklists, by employees within a process.					

Material non-compliance with applicable legislation

The following serve as examples of more serious issues revealed:

Municipal Finance Management Act, 2003 (Act No. 56 of 2003) (MFMA)

- Section 75 requires that certain information, including the annual report, be placed on the website of the municipality. Section 21A of the Municipal Systems Act states that if the municipality does not have a website it should disclose the required information on an organised local government website sponsored by the National Treasury. No evidence could be found that this was done.
- Section 27 of the MFMA states that should the mayor of the municipality become aware of any impending non-compliance with any provisions of the MFMA or any other legislation pertaining to the tabling or approval of the annual budget or compulsory consultation processes, he/she must inform the MEC for Finance and

the National Treasury in writing of such non-compliance or remedial action to be taken. No correspondence of this nature could be presented.

63. There was no documentary proof that the accounting officer submitted a draft service delivery and budget implementation plan for the budget year within 14 days after the approval of the annual budget as required by section 69(3)(a).

64. Section 69(3)(b) requires that drafts of the annual performance agreements as required in terms of section 57(1)(b) of the Municipal Systems Act for the municipal manager and all senior managers must be submitted to the mayor no later than 14 days after the approval of the annual budget. Proof could not be presented that this was done.

65. Section 17 requires certain information to be included in the budget when tabled, for example:

- information regarding any proposed amendments to the municipality's integrated development plan;
- proposed amendments to the budget-related policies;
- information regarding any proposed new municipal entities;
- service delivery agreements or material amendments to existing service delivery agreements; and
- details of the proposed cost for the budget year to a municipal entity under the sole control of the municipality.

No evidence could be obtained that this information was submitted with the budget.

66. The adjustment budget was not accompanied by an explanation of the impact of the adjustment budget on the annual budget, nor was the budget accompanied by an explanation of the impact of the increased spending on the annual budgets for the next two years as required by section 28.

67. Evidence that the mayor did within 30 days of the end of each quarter submit a report to the council on the implementation of the budget and the financial state of affairs of the municipality as required by section 52 could not be submitted.

68. The monthly budget reports of the municipality indicate that it had negative cash flows for a number of months. This is an indication of non-compliance with section 65(2)(h) which requires that the accounting officer must take all reasonable steps to ensure that the municipality's available working capital is managed effectively and economically in terms of the prescribed cash management and investment framework.

69. Section 71(1) of the MFMA requires that the accounting officer of a municipality must by no later than 10 working days after the end of each month submit to the mayor of the municipality and the relevant provincial treasury a monthly budget statement in the format prescribed by section 71(1). Several of these monthly reports were not submitted timeously/at all.

70. Supporting documentation could not be obtained to verify that the annual budget was submitted to the National Treasury and the relevant provincial treasury in printed and electronic format as required by section 24.

71. Section 64(3) of the MFMA requires the municipality to report all outstanding balances relating to organs of state to the National Treasury. Upon inspection of the report it was noted that no outstanding balances were reported although there were amounts owed to the municipality by at least some of the provincial departments.

Matters of governance

72. The MFMA tasks the accounting officer with a number of responsibilities concerning financial and risk management and internal control. Fundamental to achieving this is the implementation of certain key governance responsibilities, which we have assessed as follows:

No.	Matter of governance	Yes	No
	Audit committee		
1(a)	The municipality had an audit committee in operation throughout the financial year.		X
1(b)	The audit committee operates in accordance with approved written terms of reference.		X
1(c)	The audit committee substantially fulfilled its responsibilities for the year, as set out in section 166(2) of the MFMA.		X
	Internal audit		
2(a)	The municipality had an internal audit function in operation throughout the financial year.	X	
2(b)	The internal audit function operates in terms of an approved internal audit plan.	X	
2(c)	The internal audit function substantially fulfilled its responsibilities for the year, as set out in section 165(2) of the MFMA.	X	
	Other matters of governance		
3	The annual financial statements were submitted for audit as per the legislated deadlines in section 126 of the MFMA.	X	
4	The annual report was submitted to the auditor for consideration prior to the date of the auditor's report.		X
5	The financial statements submitted for audit were not subject to any material amendments resulting from the audit.	X	
6	No significant difficulties were experienced during the audit concerning delays or the unavailability of expected information and/or the unavailability of senior management.		X
7	The prior year's external audit recommendations have been substantially implemented.		X
8	The provincial SCOPA resolutions have been substantially implemented.	X	
9	There are documented policies and procedures and control systems to ensure the reliability of financial reporting.		X
10	There are documented policies and procedures and control systems to ensure compliance with applicable laws and regulations.		X

No.	Matter of governance	Yes	No
11	The information systems were appropriate to facilitate the preparation of financial statements that are free from material misstatement.	X	
12	Delegations of responsibilities are in place.	X	
13	Supply chain management policies and procedures were appropriately applied.	X	
14	There is a functioning performance management system.	X	
15	Based on the available information, performance bonuses are only paid after proper assessment and approval by those charged with governance.	X	

Unaudited supplementary schedules

73. The municipality provided supplementary information in the financial statements on whether resources were obtained and used in accordance with the legally adopted budget, in accordance with GRAP 1 - *Presentation of Financial Statements*. The supplementary budget information set out on pages xx to xx does not form part of the financial statements and is presented as additional information. Accordingly I do not express an opinion thereon.

OTHER REPORTING RESPONSIBILITIES

REPORT ON PERFORMANCE INFORMATION

I have reviewed the performance information as set out on pages xx to xx.

Responsibility of the accounting officer for the performance information

74. In terms of section 121(3)(c) of the MFMA, the annual report of a municipality must include the annual performance report of the municipality prepared by the municipality in terms of section 46 of the Local Government: Municipal Systems Act, 2000 (Act No. 32 of 2000) (MSA).

Responsibility of the Auditor-General

75. I conducted my engagement in accordance with section 13 of the PAA read with *General Notice 616 of 2008*, issued in *Government Gazette No. 31057 of 15 May 2008* and section 45 of the MSA.

76. In terms of the foregoing my engagement included performing procedures of an audit nature to obtain sufficient appropriate evidence about the performance information and related systems, processes and procedures. The procedures selected depend on the auditor's judgement.

77. I believe that the evidence I have obtained is sufficient and appropriate to report that no significant findings have been identified as a result of my audit.

OTHER REPORTS

Investigations

78. In terms of *General Notice R40* published in *Government Gazette No. 30521 of 27 November 2007*, the President of the Republic of South Africa requested an investigation into several matters concerning the affairs of the municipality. As this investigation has not reached finality, it is not known what impact, if any, the matter under investigation could have on the financial transactions or whether it would result in the municipality suffering losses. This matter will be reported on, once the investigation has been finalised.
79. The South African Police Service is also currently conducting an investigation into the alleged misappropriation of funds relating to services acquired by the municipality.

APPRECIATION

80. The assistance rendered by the staff of the Maluti-a-Phofung Local Municipality during the audit is sincerely appreciated.

Auditor-General
Bloemfontein
5 December 2008



A U D I T O R - G E N E R A L

REPORT OF THE AUDITOR-GENERAL TO THE FREE STATE LEGISLATURE, THE COUNCIL OF THE PARENT MUNICIPALITY AND THE BOARD OF DIRECTORS ON THE FINANCIAL STATEMENTS AND PERFORMANCE INFORMATION OF MALUTI-A-PHOFUNG WATER (PTY) LTD FOR THE YEAR ENDED 30 JUNE 2008

REPORT ON THE FINANCIAL STATEMENTS

Introduction

1. I was engaged to audit the accompanying financial statements of Maluti-a-Phofung Water (Pty) Ltd which comprise the statement of financial position as at 30 June 2008, statement of financial performance, statement of changes in net assets and cash flow statement for the year then ended, and a summary of significant accounting policies and other explanatory notes and the directors' report, as set out on pages [xx] to [xx].

Responsibility of the accounting officer for the financial statements

2. The accounting officer is responsible for the preparation and fair presentation of these financial statements in accordance with the basis of accounting determined by the National Treasury, as set out in accounting policy note 1 and in the manner required by the Local Government: Municipal Finance Management Act, 2003 (Act No. 56 of 2003) (MFMA), the Companies Act, 1973 (Act No. 61 of 1973) and the Division of Revenue Act, 2007 (Act No. 1 of 2007) (DoRA). This responsibility includes:
 - designing, implementing and maintaining internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error
 - selecting and applying appropriate accounting policies
 - making accounting estimates that are reasonable in the circumstances.

Responsibility of the Auditor-General

3. As required by section 188 of the Constitution of the Republic of South Africa, 1996 read with section 4 of the Public Audit Act, 2004 (Act No. 25 of 2004) (PAA), my responsibility is to express an opinion on these financial statements based on conducting the audit in accordance with the International Standards on Auditing and *General Notice 616 of 2008*, issued in *Government Gazette No. 31057 of 15 May 2008*. Because of the matters discussed in the Basis for disclaimer of opinion paragraphs, however, I was not able to obtain sufficient appropriate audit evidence to provide a basis for an audit opinion.
4. Paragraph 11 et seq. of the Statement of Generally Recognised Accounting Practice, GRAP 1 *Presentation of Financial Statements* requires that financial reporting by entities shall provide information on whether resources were obtained and used in accordance with the legally adopted budget. As the budget reporting standard is not effective for this financial year, I have determined that my audit of any disclosures made by Maluti-a-Phofung Water (Pty) Ltd in this respect will be limited to reporting on non-compliance with this disclosure requirement.

Basis of accounting

5. The municipal entity's policy is to prepare financial statements on the basis of accounting determined by the National Treasury, as set out in accounting policy note 1.

Basis for disclaimer of opinion

Property, plant and equipment

6. As a result of the matters detailed below, I was unable to obtain sufficient appropriate audit evidence to gain adequate audit assurance as to the existence, valuation, completeness, presentation and disclosure of and the entity's rights to property, plant and equipment with a carrying value of R5 322 709 (2007: R5 796 586) for the current and prior financial years:
 - 6.1. The descriptions, serial numbers, location and condition of assets as indicated in the fixed asset register were inadequate. Furthermore, the municipal entity did not conduct asset verification during the year and the individual assets were not numbered. The entity's records did not permit the performance of alternative audit procedures and therefore I was unable to perform all the procedures I considered necessary to obtain adequate audit assurance as to the existence, valuation, completeness, presentation and disclosure of and the entity's rights to property, plant and equipment.
 - 6.2. Management did not review the residual values and useful lives of assets classified as property, plant and equipment as required by paragraphs 30 and, 51 of IAS 16 (AC123), *Property, Plant and Equipment*, for the current and prior financial years. Furthermore, management has not assessed whether there was any indication that assets may be impaired as required by paragraph 63 of IAS 16 for the current and prior financial years. The entity's records did not permit the application of alternative audit procedures regarding the residual values, useful lives and possible impairment of assets for the current and prior financial years, consequently, I did not obtain adequate assurance with regard to the valuation of property, plant and equipment and the accuracy and completeness of depreciation and impairment of assets included in operating expenses for the current and prior financial years.
 - 6.3. Sufficient documentation could not be presented to substantiate property, plant and equipment with a cost price of R3 234 559 that were transferred from the parent municipality with the establishment of the municipal entity during the 2005-06 financial year. Furthermore, no proof could be presented that these assets were subject to any fair value evaluation and measured accordingly when the entity was formed as required by paragraph 36 of IFRS 3, *Business Combinations*. The entity's records did not permit the application of alternative audit procedures regarding these assets. Consequently, I did not obtain adequate assurance with regard to the valuation and completeness of and the entity's rights to these assets.

Trade and other receivables

7. The Maluti-a-Phofung Local Municipality debtor amounting to R17 968 217 as reflected in note 4 to the financial statements could not be confirmed with the municipality. The entity's records did not permit the application of alternative audit procedures regarding this receivable. Consequently, I did not obtain adequate assurance with regard to the valuation of this debtor's balance.
8. No supporting documentation could be obtained for journals that have a net credit impact of R60 600 942 on trade and other receivables. Due to inadequate referencing of journals in the accounting system, I could not determine the other accounts that were impacted by these journals. The entity's records did not permit the performance of alternative audit procedures regarding these journals. I could therefore not determine whether these journals were valid and accurately recorded and I could not gain adequate audit assurance as to the valuation and allocation of trade and other receivables.
9. Sufficient documentation could not be presented to substantiate accounts receivable amounting to R2 060 056 that were transferred from the parent municipality with the establishment of the municipal entity in the preceding financial year. This amount represents the residual interest in the transferred assets after deducting the liabilities and should therefore have been recognised and disclosed as equity. Equity and accounts receivable were therefore overstated by this amount.
10. Paragraphs 31 to 42 of IFRS 7, *Financial Instruments: Disclosure*, require disclosure of the nature and extent of risks arising from financial instruments, as well as specific qualitative and quantitative disclosures and credit risk information. The relevant information was not disclosed in the financial statements of the entity due to an oversight by management.

Revenue

11. In terms of the contract between the entity and the parent municipality, the entity only becomes entitled to receive payment for the delivery of water sewerage services once the municipality has received payment from the consumers. In accordance with paragraph 9 of IAS 18 (AC111), *Revenue*, revenue is recognised when the money is received by the municipality from the consumers. Detailed information could not be submitted with regard to the receipts from consumers by the municipality and the adjustments processed with regard to these receipts. The entity's records did not permit the application of alternative audit procedures with regard to revenue. Consequently, I could not obtain sufficient, appropriate audit evidence with regard to the accuracy, completeness, occurrence and cut-off of revenue of R33 482 490 (2007: R35 849 003) as disclosed in the statement of financial performance and note 9 to the financial statements.
12. No supporting documentation could be obtained for journals that have a net debit impact of R5 784 519 on revenue. Due to inadequate referencing of journals in the accounting system, I could not determine the other accounts that were impacted by these journals. The entity's records did not permit the performance of alternative audit procedures regarding these journals. I could therefore not determine whether

these journals were valid and accurately recorded and I could not gain adequate audit assurance as to the accuracy and allocation of revenue.

Grants

13. Contrary to paragraph 39 of IAS20 (AC134), *Accounting for Government Grants and Disclosure of Government Assistance*, the entity did not disclose the following with regard to government grants due to an oversight by management:

- the accounting policy adopted for government grants, including the methods of presentation adopted in the financial statements
- the nature and extent of government grants recognised in the financial statements and an indication of other forms of government assistance from which the entity has directly benefited
- unfulfilled conditions and other contingencies attaching to government assistance that has been recognised.

Inventory

14. As a result of the matters detailed below, I was unable to obtain sufficient appropriate audit evidence to gain adequate audit assurance as to the completeness, existence, valuation, presentation and disclosure of and the entity's rights to inventory with a carrying value of R2 611 917 (2007: R2 217 314) as disclosed in the statement of financial performance and note 3 to the financial statements for the current and the prior year:

- 14.1. An inventory list that includes the inventory code, description, quantity on hand and value per unit could not be submitted by management. The entity's records did not permit the application of alternative audit procedures regarding inventories. Consequently, I did not obtain sufficient, appropriate audit evidence with regard to the completeness, existence and valuation of, and the entity's rights to, inventory.
- 14.2. In terms of paragraph 6 of IAS2 (AC108), *Inventories*, water reserves that were held for resale via the network should be recognised as inventory. The water reserves were, however, not recognised as inventory during the year under review. The entity's records did not permit the application of alternative audit procedures regarding the water reserves. Accordingly, I was not able to determine the amount by which inventory is understated and cost of sales is overstated.
- 14.3. Paragraph 9 of IAS 2 (AC108), *Inventories*, requires that inventories have to be measured at the lower of cost and net realisable value. Management did not evaluate the carrying value of inventory at year-end to ensure that inventory is disclosed at the lower of cost and net realisable value. The entity's records did not permit the application of alternative audit procedures regarding the carrying value of inventory. Accordingly, I was not able to determine the amount by which inventory and operating expenses were misstated.

- 14.4. A number of variance reports that resulted from stock counts that were performed could not be submitted by management to substantiate the stock adjustments recognised in the detailed ledger amounting to R3 365 523. The entity's records did not permit the application of alternative audit procedures regarding the stock adjustments. Consequently, I did not obtain adequate assurance with regard to the accuracy, completeness and occurrence of the stock adjustments and the valuation of inventory and the accuracy of operating expenses.
- 14.5. No supporting documentation could be obtained for a journal that had a debit impact of R1 464 468 on inventory and a credit impact of R1 284 621 on water sales and R179 847 on the VAT control. The entity's records did not permit the performance of alternative audit procedures regarding this journal. I could therefore not determine whether this journal was valid and accurately recorded and I could not gain adequate audit assurance as to the valuation of inventory and the accuracy and allocation of revenue.

Trade and other payables

15. I was unable to obtain sufficient appropriate audit evidence in respect of purchases accruals amounting to R13 028 978 that were included in the trade and other payables disclosed in note 8 to the financial statements because the relevant supporting documentation could not be submitted by management. The entity's records did not permit the application of alternative audit procedures regarding purchases accruals. Consequently, I did not obtain all the information and explanations I considered necessary with regard to the existence, valuation and completeness of these payables and whether the payables represent obligations of the entity as well as the accuracy, completeness, occurrence and cut-off of cost of sales.
16. No supporting documentation could be submitted by management for a journal that had a credit impact of R354 730 on trade and other payables and a debit impact on other operating expenses. The entity's records did not permit the performance of alternative audit procedures regarding this journal. I could therefore not determine whether this journal was valid and accurately recorded and I could not gain adequate audit assurance as to the valuation of trade and other payables and the accuracy and allocation of other operating income.
17. The definitions in GRAP 1, *Presentation of Financial Statements*, defines a liability as present obligations of the entity arising from past events, the settlement of which is expected to result in an outflow from the entity of resources embodying economic benefits or service potential. Contrary to this requirement, an amount of R383 694 that was owed by the entity to Maluti-a-Phofung Local Municipality was incorrectly cleared to operating expenditure due to an oversight by management. Consequently, trade and other payables and operating expenses were understated by R383 694.
18. Paragraph 11(b) of IAS37 (AC130), *Provisions, Contingent Liabilities and Contingent Assets*, defines an accrual as liabilities to pay for goods or services that have been received or supplied but have not been paid. Due to an oversight management did not apply the definition of an accrual correctly and payments made

after 30 June 2008 amounting to R976 046 that related to expenditure incurred by the company within the financial year were not recognised as payables in the financial statements. Furthermore, during the current and previous years' audits invoices amounting to R587 252 were identified that were not recognised in the 2006-07 financial year, although they related to the 2006-07 financial year. This resulted in payables being understated by R976 046, operating expenditure understated by R231 099, the VAT liability overstated by R119 865 and the opening balance of accumulated surplus overstated by R625 082.

Expenditure

19. No supporting documentation could be submitted by management for journals that have a net debit impact of R4 921 792 on operating expenses, R1 542 772 on provisions and a net credit impact of R3 242 216 on cost of sales, R466 617 on accounts receivable and R2 755 731 on accounts payable. The entity's records did not permit the performance of alternative audit procedures regarding these journals. I could therefore not determine whether these journals were valid and accurately recorded and I could not gain adequate audit assurance as to the accuracy and classification of operating expenses.
20. Supporting documentation with regard to operating expenditure amounting to R217 660 could not be submitted by management. The entity's records did not permit the performance of alternative audit procedures regarding these expenses. Consequently, I did not obtain adequate assurance with regard to the accuracy, occurrence and allocation of operating expenditure.
21. The relevant contracts for payments totalling R1 102 600 in respect of operating expenditure were not submitted by management. The entity's records did not permit the performance of alternative audit procedures regarding these payments. I could therefore not determine whether these payments were valid and could not gain adequate audit assurance as to the occurrence of expenditure and that irregular expenditure was not incurred.
22. All the relevant tender documentation for payments totalling R746 833 in respect of operating expenditure was not submitted by management. The entity's records did not permit the performance of alternative audit procedures regarding these tender documents. I could therefore not determine whether the supply chain management policy was followed in all respects with regard to the awarding of these tenders and that irregular expenditure was not incurred.
23. Paragraph 7 of IAS16 (AC123), *Property, Plant and Equipment*, requires that the cost of an item of property, plant and equipment shall be recognised as an asset if it is probable that future economic benefits associated with the item will flow to the entity and the cost of the item can be measured reliably. Contrary to this requirement, expenditure relating to items of property, plant and equipment amounting to R826 061 was included under operating expenses in the statement of financial performance. This is as a result of the wrong interpretation of the requirements of IAS 16 by management. Consequently, operating expenditure is overstated by R826 061 and property, plant and equipment understated by the same amount.

24. Paragraph 49 of IAS 19 (AC116), *Employee Benefits*, requires the disclosure of the amount recognised as an expense for defined contribution plans. Due to an oversight by management the amount of R3 431 137 relating to this expense was not disclosed in terms of IAS 19 in the financial statements.

Value-added tax (VAT)

25. A difference of R4 010 075 was identified between the audit evidence submitted and the balance with regard to outstanding VAT included in trade and other payables as disclosed in note 8 to the financial statements amounting to R3 703 857. No explanation or supporting documentation could be submitted by management with regard to the identified difference. The entity's records did not permit the application of alternative audit procedures regarding the outstanding VAT balance. Consequently, I did not obtain adequate assurance with regard to the valuation and presentation and disclosure of the outstanding VAT balance.

26. Section 7 of the Value-Added Tax Act, 1991 (Act No. 89 of 1991) requires that VAT has to be levied on the supply by any vendor of goods or services supplied by him in the course or furtherance of any enterprise carried on by him. Contrary to this requirement, VAT of R506 800 was not levied on invoices issued to the parent municipality with regard to the supply of water and sewerage services due to an oversight by management. Consequently, the outstanding VAT balance included in trade and other payables was understated by R506 800 and revenue was overstated by the same amount.

27. In terms of section 5A of the VAT Act, a vendor shall be deemed to supply services to any municipality to the extent of any grant paid to, or on behalf of, that vendor in respect of the taxable supply of goods or services by that vendor. Contrary to this requirement, VAT of R5 574 316 was not levied on invoices that were issued to the parent municipality with regard to grants that were paid to the entity due to an oversight by management. Consequently, the outstanding VAT balance included in trade and other payables was understated by R5 574 316 and revenue was overstated by the same amount.

Cash and cash equivalents

28. Paragraph 39 of IAS 39 (AC133), *Financial Instruments: Recognition and Measurement*, requires that an entity shall remove a financial liability (or a part of a financial liability) from its balance sheet when, and only when, it is extinguished - i.e. when the obligation specified in the contract is discharged or cancelled or expires. Contrary to the requirements of paragraph 39 of IAS 39, outstanding payments amounting to R1 678 123 were recorded against the bank account as reflected on the statement of financial position. This amount should be reversed as the payments were not processed through the bank account at year-end and the financial liability had not been extinguished. This matter arose due to a cut-off mistake by management. The result of the error was that cash and cash equivalents and payables were understated by R1 678 123.

Provisions

29. I was unable to obtain sufficient appropriate audit evidence in respect of provisions amounting to R6 124 652 as disclosed in the statement of financial position and note 7 to the financial statements because the relevant supporting documents could not be submitted by management. The entity's records did not permit the application of alternative audit procedures regarding provisions. Consequently, I did not obtain all the information and explanations I considered necessary with regard to the existence, valuation and completeness of this provision and whether the provision represents obligations of the entity as well as the accuracy, completeness, occurrence and cut-off of employee cost included in operating expenses.
30. Paragraph 11 of IAS 37 (AC130), *Provisions, Contingent Liabilities and Contingent Assets*, defines accruals as liabilities for goods or services received, including accrued leave pay. Contrary to the requirements of IAS 37, the leave accrual was disclosed in the financial statements as a provision totalling R6 124 652 and in terms of IAS 37 it should have been disclosed as an accrual. The reason for the error is the misinterpretation of the requirements of the standard by management. The result of the error is that provisions was overstated and accruals understated by this amount.

Contingent liabilities

31. In terms of paragraph 86(a) of IAS37 (AC130), *Provisions, Contingent Liabilities and Contingent Assets*, the amount recognised as a contingent liability shall be the best estimate of the expenditure required to settle the present obligation at the end of the reporting period. Due to an oversight by management, this requirement was not complied with and the contingent liability of R4 000 000 with regard to the award made by the previous CEO as disclosed in note 12 to the financial statements was understated by R1 343 185.
32. Included in contingent liabilities as disclosed in note 12 to the financial statements was an amount of R431 545 with regard to a lease. Paragraph 33 of IAS 17 (AC105), *Leases*, requires lease payments under an operating lease to be recognised as an expense on a straight-line basis over the lease term, unless another systematic basis is more representative of the time pattern of the user's benefit. The company disclosed the liability of a lease for a vehicle monitoring system as a contingent liability to the amount of R431 545. The reason for the error is the misinterpretation of the requirements of IAS 17 by management. The impact of the error is that contingent liabilities were overstated by R431 545. Furthermore, the disclosure required by paragraph 35 of IAS 17 with regard to operating leases was not included in the financial statements.

Related parties

33. Paragraph 12 of IAS 24 (AC126), *Related Party Disclosures*, requires that relationships between parents and subsidiaries shall be disclosed irrespective of whether there have been transactions between those related parties. Furthermore, paragraph 17 of IAS 24 requires that if there have been transactions between related parties, an entity shall disclose the nature of the related-party relationship as well as information about the transactions and outstanding balances necessary for

an understanding of the potential effect of the relationship on the financial statements. Contrary to these requirements no disclosure was included in the financial statements of transactions with the holding entity and the management company due to an oversight by management.

Irregular expenditure

34. In terms of section 1 of the MFMA a municipal entity incurs irregular expenditure, *inter alia*, when the expenditure is in contravention of the MFMA or if the expenditure is in contravention of the entity's supply chain management policy. In terms of this definition, irregular expenditure amounting to R208 996 was incurred because the number of written quotations as required by the supply chain management policy was not obtained. Furthermore, the expenditure was not disclosed in the financial statements as irregular expenditure as required by section 125(2)(d) of the MFMA.
35. A tender was awarded for the implementation of a performance management system and the minutes of the bid committee meetings could not be submitted by management. An amount of R227 188 was paid in terms of this tender during the year. The entity's records did not permit the application of alternative procedures regarding these meetings. Consequently, I could not obtain adequate assurance that irregular expenditure of R227 188 had not been incurred by the entity.

Cash flow statement

36. Paragraph 15 of GRAP 2, *Cash Flow Statements*, requires the cash flow statement to be presented using the direct method. Due to an oversight by management, the cash flow statement was presented using the indirect method and this is contrary to the requirements of GRAP 2.
37. I was not able to determine whether the cash flow statement and the related notes are fairly stated due to the material effect on the cash flow statement and related notes, of scope limitations and identified misstatements as reported in this report.

Opening balances

38. As described in the previous year's audit report material uncertainties were discovered in the financial statements of the municipal entity for the year ended 30 June 2007 that related to revenue, trade and other receivables, operating expenses, provisions, property, plant and equipment, inventory, trade and other payables, cash and cash equivalents, irregular expenditure and accumulated surplus. The findings remained unresolved from the previous year's audit report and therefore impacted on the opening balances for the year under review.

Other disclosures and presentations

39. The entity did not disclose the following matters in the notes to the financial statements that are required by GRAP1, *Presentation of Financial Statements*:
 - 39.1. Paragraphs 97 and 98 require that when items of revenue and expense are material, their nature and amount shall be disclosed separately.

- 39.2. Paragraph 99 requires that an entity shall present, either on the face of the statement of financial performance or in the notes to the statement of financial performance, a sub-classification of total revenue, classified in a manner appropriate to the entity's operations.
- 39.3. Paragraph 106 requires that entities classifying expenses by function shall disclose additional information on the nature of expenses, including depreciation and amortisation expense, and employee benefits expense.
40. The entity did not disclose the following matters in the notes to the financial statements that are required by paragraph 43 of the Fourth Schedule of the Companies Act (Act no 61 of 1973):
 - 40.1. Paragraph (h): the respective amounts paid as remuneration for managerial, technical, administrative or secretarial services, however described, other than to the bona fide employees of the company
 - 40.2. Paragraph (i): the amount paid to the auditors
 - 40.3. Paragraph (r): the amount of operating lease charges distinguishing between the major categories of assets held under operating lease
 - 40.4. Paragraph (s): items of income and expense which, in the accounting period, are material items and result from occurrences the underlying nature of which is typical of the ordinary trading or operating activities of the enterprise

Disclaimer of opinion

41. Because of the significance of the matters described in the Basis for disclaimer of opinion paragraphs, I have not been able to obtain sufficient appropriate audit evidence to provide a basis for an audit opinion on the financial statements of Maluti-a-Phofung Water (Pty) Ltd. Accordingly, I do not express an opinion on the financial statements.

OTHER MATTERS

I draw attention to the following matters that relate to my responsibilities in the audit of the financial statements:

Internal controls

42. Section 95(1)(c)(i) of the MFMA states that the accounting officer must ensure that the municipal entity has and maintains effective, efficient and transparent systems of financial and risk management and internal control. The table below depicts the root causes that gave rise to the inefficiencies in the system of internal control, which led to the disclaimer of opinion. The root causes are categorised according to the five components of an effective system of internal control. In some instances deficiencies exist in more than one internal control component.

Reporting item	Control environment	Risk assessment	Control activities	Information and communication	Monitoring
Property, plant and equipment			X		X
Trade and other receivables			X		X
Revenue	X		X		X
Grants			X		X
Inventory			X		X
Trade and other payables			X		X
Expenditure			X		X
Value-added tax (VAT)			X		X
Cash and cash equivalents			X		X
Provisions			X		X
Contingent liabilities			X		X
Related parties			X		X
Irregular expenditure			X		X
Cash flow statement			X		X
Opening balances	X		X		X
Other disclosures and presentations			X		X
Control environment: establishes the foundation for the internal control system by providing fundamental discipline and structure for financial reporting.					
Risk assessment: involves the identification and analysis by management of relevant financial reporting risks to achieve predetermined financial reporting objectives.					
Control activities: policies, procedures and practices that ensure that management's financial reporting objectives are achieved and financial reporting risk mitigation strategies are carried out.					
Information and communication: supports all other control components by communicating control responsibilities for financial reporting to employees and by providing financial reporting information in a form and time frame that allow people to carry out their financial reporting duties.					
Monitoring: covers external oversight of internal controls over financial reporting by management or other parties outside the process; or the application of independent methodologies, like customised procedures or standard checklists, by employees within a process.					

Non-compliance with applicable legislation

Municipal Finance Management Act, 2003 (Act No. 56 of 2003) [MFMA]

43. The company is required by section 99(2)(b) of the MFMA to pay all monies due within 30 days after receiving the relevant invoice or statement. Expenditure totalling R1 561 790 was identified that was not paid in accordance with the requirement.
44. Section 95(c)(i) requires the accounting officer to implement and maintain effective, efficient and transparent systems of financial and risk management and internal controls. It was found that no effective risk management procedures have been implemented. A number of other serious internal control weaknesses were also identified, which indicates that the requirements of section 95 had not been met.

Companies Act, 1973 (Act No. 61 of 1973)

45. Section 179 of the Companies Act requires the company to have its first annual general meeting within 18 months after the incorporation of the company. Contrary to this requirement, the first annual general meeting was only held during August 2008, 35 months after the incorporation of the company.

Matters of governance

46. The MFMA tasks the accounting officer with a number of responsibilities concerning financial and risk management and internal control. Fundamental to achieving this is the implementation of certain key governance responsibilities, which I have assessed as follows:

Matters of governance	Yes	No
Audit committee		
• The municipal entity had an audit committee in operation throughout the financial year.		X
• The audit committee operates in accordance with approved, written terms of reference.		X
• The audit committee substantially fulfilled its responsibilities for the year, as set out in section 166(2) of the MFMA.		X
Internal audit		
• The municipal entity had an internal audit function in operation throughout the financial year.		X
• The internal audit function operates in terms of an approved internal audit plan.		X
• The internal audit function substantially fulfilled its responsibilities for the year, as set out in section 165(2) of the MFMA.		X
Other matters of governance		
• The annual financial statements were submitted for auditing as per the legislated deadlines in section 126 of the MFMA.		X
• The annual report was submitted to the auditor for consideration prior to the date of the auditor's report.		X
• The financial statements submitted for auditing were not subject to any material amendments resulting from the audit.	X	
• No significant difficulties were experienced during the audit concerning delays or the unavailability of expected information and/or the unavailability of senior management.		X
• The prior year's external audit recommendations have been substantially implemented.		X
• SCOPA resolutions have been substantially implemented.	N/A	

Unaudited supplementary schedules

47. The municipal entity provided supplementary information in the financial statements on whether resources were obtained and used in accordance with the legally adopted budget. The supplementary budget information included in the statement of financial position, statement of financial performance and the cash flow statement set out on pages xx to xx does not form part of the financial statements and is presented as additional information. Accordingly, I do not express an opinion thereon.

48. The detailed statement of financial performance set out on pages XX to XX do not form part the financial statements and is presented as additional information. I have not audited this and accordingly I do not express an opinion on it.

OTHER REPORTING RESPONSIBILITIES

REPORT ON PERFORMANCE INFORMATION

49. I was engaged to review the performance information.

Responsibility of the accounting officer for the performance information

50. In terms of section 121(4)(d) of the MFMA, the annual report of a municipal entity must include an assessment by the entity's accounting officer of the entity's performance against any measurable performance objectives set in terms of the service delivery agreement or other agreement between the entity and its parent municipality.

Responsibility of the Auditor-General

51. I conducted my engagement in accordance with section 13 of the PAA read with *General Notice 616 of 2008*, issued in *Government Gazette No. 31057 of 15 May 2008*.

52. In terms of the foregoing my engagement included performing procedures of an audit nature to obtain sufficient appropriate evidence about the performance information and related systems, processes and procedures. The procedures selected depend on the auditor's judgement.

53. I believe that the evidence I have obtained is sufficient and appropriate to provide a basis for the audit findings reported below.

Audit findings (performance information)

Non-compliance with regulatory requirements

54. Contrary to the requirements of section 121(4)(d) of the MFMA, the municipal entity did not submit for evaluation as part of the audit process the assessment by the entity's accounting officer of the entity's performance against the measurable performance objectives set in terms of the service delivery agreement between the entity and its parent municipality.

Delay in the finalisation of the audit

55. The financial statements were only received on 6 October 2008. As a result of this and due to the closing of offices during the festive season, the finalisation of the audit was delayed.

APPRECIATION

56. The assistance rendered by the staff of the Maluti-a-Phofung Water (Pty) Ltd during the audit is sincerely appreciated.

Auditor-General
Bloemfontein

27 January 2009



A U D I T O R - G E N E R A L